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STATEMENT OF THE NATIONAL ASSOCIATION OF RETIRED FEDERAL EMPLOYEES BEFORE THE SENATE COMMITTEE ON GOVERNMENTAL AFFAIRS ON S.1527, DESIGN OF A SUPPLEMENTAL RETIREMENT PROGRAM FOR FEDERAL EMPLOYEES HIRED AFTER 1983

Tuesday, September 10, 1985

I am L. J. "Lud" Andolsek, President of the National Association of Retired Federal Employees (NARFE). It is a pleasure to appear before this Committee to assist in the construction of a supplemental retirement program for new employees. Although the benefits of this program will not directly affect our members who are already retired, we feel privileged to provide you with a look at this important matter through the eyes of age.

We, more than anyone else, recognize the legitimate purposes of a retirement system. As former government managers, we understand the need to provide a sensible progression into retirement for older workers so that new generations can take over the reins. As current retirees we, more than others, recognize the income replacement and security needs of those who have completed their careers as productive wage earners, and earned the right to retire with security. As patriotic citizens we agree with the legitimate need for a social safety net established in our national policies for half a century, which is most often achieved through retirement programs provided by employers for the productive members of our society and their families.

Finally, as those who have felt the ebb and flow of political tides enrich and then threaten our dignity and security, we recognize the need to insulate this new program as much as possible from political pressures. This means neither hiding it nor putting it totally beyond the reach of political leaders. What it does mean is constructing a plan which is consistent with private sector practices while recognizing the unique needs and mission of a unique employer -- the government. It means creating a program which both employees and the public can understand and view as fair; it means guaranteeing the program's fiscal health through an unwavering commitment by the U.S. government itself; but -- most importantly -- it means designing a program which will attract into the public service the "best and the brightest" so that the Federal government, as the Nation's largest employer, is also its model employer.

NARFE believes it is important to design a new plan that will satisfy several major goals:

- It should provide an adequate retirement income for the new employees across the full spectrum of job classifications and salary grades;
- It should be a program that will be fair to new hires, the 5 million employees and annuitants still under the current Civil Service Retirement System, and the public;
- It should be funded in a manner that will protect the financial integrity of the current system into the future;
- It should meet the federal government's continuing need to attract and retain a quality workforce that can execute the many different functions of government at the high performance level to which the American taxpayer is entitled.

How do we translate these goals into a supplemental retirement program?

Mr. Chairman, the bill that you and Senator Roth have introduced to establish a retirement system for federal and postal employees hired since December 31, 1983 is a good starting point. Our organization has had this matter under study during the two years since Social Security coverage was enacted, and the conclusions we have reached about the most desirable approach coincide with your proposal in many ways.

You have proposed a three-tier system for the new employees. We strongly support this concept. Social Security should be supplemented with a defined benefit plan that each covered employee can count on to provide an adequate income in retirement when added to Social Security. We also agree that the supplemental should be an add-on, as you propose, and not offset by a part of Social Security.

Experience in the private sector has demonstrated that the third tier of your plan is also an important employee benefit. Saving for retirement through a tax-deferred capital accumulation plan is now widely recognized as an effective way to build additional retirement assets for those who want the security of the extra income such assets can generate.

We applaud your bill for its commitment to continue the existing Civil Service Retirement Trust Fund on a financially sound footing. We agree that the existing fund should serve both the current system and the new plan on an integrated basis that does not earmark revenues by plan. It is essential that we keep faith with current retirees and those who expect to retire under the current system and assure them that the new plan will not weaken the strong financial outlook for the Trust Fund.

We appreciate the work you and your staff have put into development of this very complex legislation, Mr. Chairman. We feel that you have given the

Committee a well-structured proposal for markup. I want to urge you and the other Committee members to use the markup to remedy those provisions that we believe do not serve the best interests of retirees, federal and postal employees, or the government as employer.

The deficiencies of S.1527 can be summed up in one word - value. According to the analysis of the Congressional Research Service, the average employee would contribute 8.9 percent of salary to receive a benefit worth 29.7 percent of salary. What these numbers mean is that the employee's contribution would be 1.7 percentage points greater, but the benefit would be worth 2.5 points less than now exists. This total swing in value to the employee of 4.2 percent of salary would amount to a reduction of one-sixth in the value of the retirement program for the new hire as compared to other employees.

The excellent study of compensation produced by Hay-Huggins for the House last year found that total federal compensation lags the average private firm's by 7.2 percent. That means that it lags the top firms by even more. While the Civil Service Retirement System was 6.4 percent better than the average firm's retirement plan, it was found to be less generous than the plans of at least 85 of the firms in the study. These results mean that when the federal government goes up against the IBMs and the DuPonts in the labor market, it offers the job prospect lower pay, a less generous health plan, and lower retirement benefits. How can we seriously consider worsening this situation by cutting the current retirement package by one sixth?

We suggest the Committee consider two ways to reduce the government's cost under the proposal and provide more room for benefit improvement.

First, NARFE believes the long-standing tradition of employee contributions should be maintained. A 1.3 percent retirement contribution, combined with the Social Security contribution, would maintain equity between the new hires and their colleagues, provide more funds for needed benefits, and continue the politically important employee financial stake in the retirement system.

The second way to provide funds for benefit improvement is to pare back the proposed capital accumulation plan. The proposed dollar-for-dollar match on the first 5 percent of pay is much more generous than the matching in most private sector plans. This generosity would not only exceed current practice, but it would also fly in the face of the growing pressure from the Administration and some Members of Congress to curb the extent to which income can be tax-deferred through retirement saving plans.

Now that we've shown where money can be saved, we would like to identify our priorities for improving the defined benefit plan.

As a retiree organization, we recognize more than others the absolute need to protect retirement income from inflation. As a nation, we need to come to grips with the difficult issue of protecting all retirees equally from inflation. One indexing policy should be applied to Social Security and to all the non-means tested retirement programs administered by the government. This is the best way to use the powerful presence of the government to encourage private workers and employers alike to work toward a uniform indexing policy on the retirement benefits of all workers.

Under the proposal before this Committee, if you retired with a benefit worth 30 percent of the high-5 and lived for 20 years, you would wind up with a benefit in real dollars that was worth only 20 percent of pay if the COLA were CPI minus 2. Losing one-third of the value of your earned retirement as you grow older cannot be called enjoying the golden years of senior citizenship. I call it bad policy. It is a policy that Congress has rejected time after time in recent years. We suspect Congress has rejected these proposals in part because of their long-term effects. As one OMB official was quoted recently, "It's only fine if you don't live very long after retirement."

NARFE strongly believes that the COLA for the supplemental should be tied to Social Security's COLA. COLA policy could then automatically follow whatever policy Congress should decide for Social Security, and the government's plan would be treated no more and no less generously than Social Security at any given point in time.

Second, let's look at the basic rate at which benefits are accrued and the salary base used to compute benefits. The proposed rate of one percent per year of service would provide a benefit worth 30 percent of the high-5 average salary for the 30-year employee at age 62. When added to Social Security, this benefit is equal to that under the current system for an employee making somewhat less than $20,000 a year. Everyone above this salary level would have less wage replacement from Social Security and therefore would have less in combined benefits than under the current system.

NARFE believes this break-even salary level of under $20,000 is too low. It is unrealistic to expect that most people in the $20,000 to $30,000 salary range will participate so substantially in the saving plan as to make up this difference in benefits. For example, this salary range covers most postal clerks and letter carriers. The result of the proposal would be to help the lowest-paid employees, who would be better off, and the highest-paid employees, who will take advantage of the CAP, but to penalize the below-average and average employees relative to current law. An accrual rate of about 1.15% using a high-3 salary base would move the break-even salary up to $30,000, which would guarantee all below-average employees that they would do at least as well as they would under the current system.

The cost of this accrual rate could be mitigated somewhat by continuing the current policy of a backloaded benefit formula which is lower in the early years of employment but increases with seniority. Accrual rates in the neighborhood of .95 for the first 10 years and 1.25 for long service would be appropriate in our view. Such an approach would save some money and encourage career employment while not diminishing the increased portability afforded short term workers through Social Security and a capital accumulation plan.

Another priority is the unreduced benefit at age 55 for the career employee with 30 or more years of service. There are two reasons for retaining the current age-service requirement. The first is the opportunity for an adequate retirement that a 30-year employee richly deserves. Preserving this right at age 55 would not be a costly change to the bill.

The second reason to retain the present retirement criteria is that taking an action to delay retirement age makes no sense given the trends in employment. There is little chance that the number of government jobs will rise much in the foreseeable future. To encourage retirement at later ages would mean fewer new hires, fewer promotions, an older workforce, and a workforce with less performance incentive. Retirement age policy must be viewed from the perspective of government as employer. Basing such policy purely on budgetary grounds or macroeconomic considerations makes no sense. We see evidence all around us in the private sector that firms in no-growth situations often use retirement as a key element in maintaining a viable workforce.

We also want to comment on several provisions in the disability and survivor plans that appear deficient. With respect to disability, we believe that benefits and the average base on which they are computed should be adjusted based on a national indexing policy.

The proposed rules for survivor benefits also require some attention. First benefits for survivors of annuitants, or employees who die in service, should begin at time of death. Second, the phasedown in the life insurance to be provided by government occurs at too early an age. If a phasedown is used, it should be no earlier than age 50 in order to be more helpful in meeting the actual financial needs of survivors.

Now I want to comment on the investment of funds in the capital accumulation plan. We feel strongly that all funds should be invested in government and government-guaranteed securities. There are several reasons why we have come to the conclusion that this approach is best. First, it avoids the potential for the political and administrative pitfalls that could well be created if large amounts of money were placed with numerous private vendors. Second, we think that taxpayers will hold the plan in higher regard if it is viewed as a way for federal employees to invest in their own employer, the U.S. Government, rather than as a way to set up civil servants with a stake on Wall Street. Third, and perhaps most persuasive of all, placing the funds outside of government would increase the budget deficit by scores of billions of dollars, a result which would surely come back to haunt the Congress as well as jeopardize the continued viability of the capital accumulation plan.

Finally, we want to address the question of allowing pre-1984 employees to opt into the new system. S.1527 proposes a one-time "open season" to permit such elections. We understand the interest in allowing an election, but it would raise two problems that must be considered. First, the Social Security Act would have to be amended to allow coverage of federal employees at the employee's option. Opening up the coverage issue could be dangerous at a time when budget pressures make new Social Security revenues attractive. Second, the choice being offered to employees would be extremely complex, and many people would no doubt make unwise choices and come to regret their decisions. This problem was cited by a witness at a House hearing based on experience in Maryland when State employees were allowed to choose between two retirement plans.

It seems that a good alternative to consider instead of the retirement open season would be to allow pre-1984 employees to participate in the capital accumulation plan. Even if their contributions were unmatched, the availability of tax-deferred saving would satisfy the major reason for any interest of pre-1984 employees in the new system.

In summary, Mr. Chairman, there is much to debate before final legislation is enacted, but you have given us a good framework within which to conduct that debate. NARFE applauds your efforts and those of your colleagues as you tackle the design of a supplemental plan. We stand ready to work with you in producing the best possible plan for retirees, Federal and Postal employees, and the government as employer.